28 U.S.C. § 157

In re Water Sports, Inc.. - Case No. 694-61950-psh11
BAP. Case. No. 95-1386-HVJ
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The BAP affirmed the bankruptcy court's order granting an injunction which required Terry Whitlock and Linda DiBlasi to turnover estate property and denied Whitlock 's motion to dismiss the debtor's Chapter 11 petition. The bankruptcy court's order was based on its finding that Terry Bendar, not Whitlock was the debtor's majority shareholder and that the petition was therefore properly filed. On appeal Whitlock contended that the court lacked subject matter jurisdiction to determine ownership of the corporate shares and, alternatively, contended that the bankruptcy court erred in determining that he was not the debtor's majority shareholder.

The BAP held that the issue of subject matter jurisdiction was properly before it, despite Whitlock's failure to raise it at the trial court level, because it may properly be raised at any time. The BAP agreed that stock ownership was not a core matter over which the court had jurisdiction but concluded that, in this case, the issue of stock ownership was central to a determination of the motion to compel turnover and the motion to dismiss, both of which were core issues, and the bankruptcy court therefore had jurisdiction to determine the stock ownership question.

The BAP rejected Whitlock's arguments that the bankruptcy court had considered improper hearsay testimony and applied an improper burden of proof in making its decision regarding stock ownership. The BAP affirmed the court's ruling that Whitlock was not the debtor's majority shareholder. P96-27(25)

Eugene DC UT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re	BAP No. OR-95-1386-HVJ
WATER SPORTS, INC.,	Bk. No. 694-61950-pshll
Debtor.	Adv. No. 694-6226-pshll
TERRY S. WHITLOCK and LINDA DIBLASI,	
Appellants,	
v.	**MEMORANDUM**
WATER SPORTS, INC.,	
Appellee.	

Argued and Submitted on May 23, 1996
at Portland, Oregon

Appeal from the United States Bankruptcy Court
for the District of Oregon

Honorable Polly S. Higdon, Bankruptcy Judge, Presiding

Before: HAGAN, VOLINN, and JONES, Bankruptcy Judges.

Terry S. Whitlock ("Whitlock") and Linda DiBlasi ("DiBlasi"), appeal: (1) an injunction requiring them to turnover the books and records of chapter 11 debtor, Water Sports, Inc. ("Water Sports"); and (2) the denial of Whitlock's motion to dismiss Water Sport's chapter 11 petition. We AFFIRM.

Both issues turn on whether William Bednar ("Bednar") or Whitlock owns a majority interest in Water Sports.

PROCEEDINGS BELOW

A. Procedural History

Water Sports filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code on May 18, 1994. Shortly after the petition for relief was filed, Bednar caused Water Sports to file an adversary proceeding against Whitlock and DiBlasi for intentional interference with business relations and turnover of corporate records. Whitlock responded by filing a motion to dismiss Water Sports' voluntary petition on the grounds that (1) Bednar did not have authority to file a bankruptcy petition on Water Sports' behalf; and (2) the petition was filed in bad faith. In the alternative Whitlock requested a chapter 11 trustee be appointed.

An extended hearing on Water Sports' motion for turnover of estate property and Whitlock's motion to dismiss was held on August 10, 1994, September 15, 1994, and September 16, 1994. However, on the morning of September 15, 1994, Whitlock withdrew his motion to dismiss and his motion for appointment of a

chapter 11 trustee because he wanted the case to remain in bankruptcy in the event he was determined to be the majority shareholder. The bankruptcy court granted him permission to refile his motion for appointment of a trustee in the event she found that Bednar was the majority shareholder of Water Sports.

B. Summary of the Evidence Presented At Trial

In July of 1990, Mike Neyt ("Neyt"), Dorian Corliss ("Corliss") and Bednar incorporated Water Sports for the purpose of manufacturing and selling a squirt gun known as the "Dip Stick." Water Sports was initially authorized to issue 30,000 shares of common stock, of which 10,000 shares were issued to each of the incorporators.

In August of 1992, Whitlock approached Water Sports and offered his marketing expertise and a squirt gun called the "Stream Machine" in exchange for employment by and a shareholder stake in Water Sports. Whitlock became the president of Water Sports in January of 1993. However, negotiations concerning Whitlock's stock ownership continued until March of 1993 when Water Sports issued 2,800 shares to him.

Meanwhile, Corliss and Neyt sold or redeemed their Water Sports' stock and the John Duke Trust (the "Duke Trust") purchased shares in Water Sports. Until mid-1994 Bednar, Whitlock, and the Duke Trust agreed that the effect of these transactions was that only 10,000 of Water Sports' 30,000 authorized shares remained outstanding and of the outstanding shares, Bednar owned 5,200 shares, Whitlock owned 2,800 shares

and the Duke Trust owned 2,000 shares.

By September of 1993, Whitlock and Bednar began to disagree about Whitlock's job performance and Bednar's business expenses. The dispute culminated in Bednar terminating Whitlock's employment. Bednar also maintained that Whitlock's stock had never been paid for and caused Water Sports to cancel Whitlock's shares.

In late 1993, Whitlock and DiBlasi filed an action in the Circuit Court for the State of Oregon, Jackson County, against Water Sports and Bednar for wages. At a stockholders meeting held in January of 1994, Whitlock also contended he, not Bednar, was the majority shareholder of Water Sports. After Bednar adjourned the meeting, Whitlock and DiBlasi reconvened the meeting and Whitlock "elected" himself as president of Water Sports. Whitlock amended his Jackson County complaint in April of 1994 to include his contention that he is the majority shareholder of Water Sports.

Relations between Bednar and Whitlock continued to deteriorate, and on the night of May 16, 1994, Whitlock removed some of the office equipment and all of the corporate records from Water Sports' offices. On May 18, 1994, Bednar responded by causing Water Sports to file a voluntary petition for relief under chapter 11 of title 11 of the U.S. Code. On the date the petition was filed, Bednar remained in control of Water Sports' finances and day to day operations, but Whitlock held all of its corporate records.

The transactions underlying the dispute began in September of 1992, when Bednar purchased Corliss' shares for $170,000. Bednar borrowed the money to purchase Corliss' shares from his friend, Faye D. Madson ("Madson"). Corliss' and Bednar's 10,000 share certificates were cancelled and Bednar was issued a new 20,000 share certificate. In January of 1993, Bednar redeemed the 10,000 shares he purchased from Corliss in exchange for Water Sports' assumption of his debt to Madison. However, Bednar's 20,000 share certificate was never cancelled and Bednar was never issued a new 10,000 share certificate. Whitlock contends that neither the stock redemption nor Water Sports' $170,000 debt to Madison was disclosed to him until after he had purchased his shares from Bednar.

Meanwhile, on November 20, 1992, as part of their ongoing negotiations, Bednar gave Whitlock a letter assuring him of a 25% interest in Water Sports upon the signing of the agreement with Neyt. Bednar testified that at the time he wrote the letter, he believed that upon execution of the Neyt agreement he would own 100% of the outstanding stock of Water Sports. Whitlock testified that Bednar told him that he would get 25% of Water Sports' 30,000 outstanding shares (*i.e.*, 7500 shares), and that when Bednar completed the purchase of Neyt's shares, Whitlock and Bednar would become fifty-fifty partners. Bednar denies he ever offered Whitlock more than 25% of the post-sale stock.

However, in the end, Bednar did not purchase Neyt's shares.

Instead, in December of 1992, Neyt entered into an agreement with Water Sports to redeem his shares for $50,000. Water Sports paid $10,000 for the shares upon execution of the redemption agreement with $40,000 to be paid on April 1, 1993. The agreement provided that Water Sports' attorney, John Grantland ("Grantland"), would hold Neyt's shares in escrow pending the final payment.

Although Neyt's shares remained in escrow until Water Sports made its final payment in April of 1993, Bednar believed and began behaving as if there were only 10,000 shares of Water Sports stock outstanding and that he was the sole owner thereof. This belief is reflected in his subsequent dealings with the Duke Trust and Whitlock. Bednar further confused the escrow issue by referring to Neyt's stock redemption as if he had personally purchased the shares from Neyt.

Sometime during this period, Bednar, Grantland, and Water Sport's accountant, Mr. Kosmatka, began to refer to Water Sports' outstanding shares as if there were only the 10,000 shares owned by Bednar. Whitlock contends that a reverse stock split occurred at this time, but there is no written evidence a reverse stock split actually occurred. Nor is there evidence of a formal stock reduction. Rather, the parties simply ignored the Neyt stock and treated Bednar's stock as if it were the only outstanding stock.

Also during the later part of 1992, Bednar began negotiations to sell the Duke Trust a minority share of the

stock. Ultimately, Water Sports issued 2000 shares directly to the Duke Trust. The sale was memorialized in two separate agreements for the sale of 1000 shares each. The recitals in the agreements ignore the existence of the Neyt stock. For example, while the second agreement states that upon purchase of the second 1000 shares, the Duke Trust owned 20% of the outstanding shares, the actual percentage of stock received by the Duke Trust was only 10% (1000 shares of the 20,000 shares outstanding).

The agreements are also somewhat ambiguous as to whether Water Sports or Bednar is the seller. The agreements state that Water Sports is selling the shares to the Duke Trust, but in the recitals, the number of Bednar's shares drops 1000 shares with each 1000 shares issued to the Duke Trust.

The agreements were executed in March of 1993 but recite that they are effective December 29, 1992. This effective date proved problematic because on December 29, 1992, Water Sports did not have any authorized shares which were not outstanding.[1] However, the agreements were later revised and re-executed effective January 1, 1993, not December 29, 1992. This revision solved the outstanding stock problem because by December 30, 1992, Bednar had redeemed the shares he purchased from Corliss, thus creating a 10,000 share pool of authorized but unissued

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[1]The Neyt shares were in escrow and Bednar had not yet transferred the Corliss shares to Water Sports. Thus all 30,000 shares remained outstanding.

stock.

Bednar's negotiations with Whitlock continued, and in early March of 1993, Grantland prepared a stock option agreement giving Whitlock the option to purchase 28% of the stock for $42,000. Grantland recommended the stock option agreement to avoid issuing shares to Whitlock without adequate consideration. Whitlock refused to sign the agreement on the grounds he and Bednar had agreed he was to receive 25% of the stock in exchange for the Stream Machine and his sales expertise.

Whitlock, Bednar, Grantland and Kosmatka met on March 18, 1993, to resolve the issue. At that meeting, the parties agreed that Whitlock would own 28%, Bednar would own 52%, and the Duke Trust would own 20% of the corporation. Accordingly, on March 20, 1993, Whitlock was issued 2,800 shares, Bednar was issued 5,200 shares and Duke Trust was issued 2,000 shares. All of the shares were backdated to January 1, 1993. The parties agreed that Whitlock would be given $42,000 in bonuses for the purpose of allowing him to pay for his stock. However, Whitlock never signed an agreement to pay Water Sports $42,000 for his stock and his stock certificate was unrestricted. Consequently, there was some tension between the shareholders as to whether Whitlock's shares were properly issued, and whether Whitlock owed Water Sports $42,000.

According to the stock ledger, all of the other share certificates previously issued were cancelled effective January 1, 1993. However, despite the entry in the stock ledger, Neyt's

shares remained uncancelled in escrow. Thus, until the escrow closed and Neyt's shares were redeemed in April of 1993, the parties' actual percentages of ownership in the corporation were: Neyt 50%, Bednar 26%, the Duke Trust 10% and Whitlock 14%.

Based upon the confused stock records of Water Sports, Whitlock has proposed a variety of scenarios under which he claims that he is the majority shareholder of Water Sports. His early theories maintain that his 2,800 shares constitute a majority because Bednar's shares were decreased by a reverse stock split and by sale to the Duke Trust and Whitlock. Later, Whitlock began contending that he received 7,500 shares (25% of 30,000) upon execution of the Neyt agreement.

At the close of the hearing, Whitlock presented three separate scenarios under which he claimed to be the majority shareholder. First, Whitlock contended that on December 15, 1992, Bednar had 20,000 shares and the 10,000 Neyt shares were in escrow. On that date a three for one reverse stock split occurred leaving Bednar with 6,667 shares. On January 1, 1993, Bednar sold 2,800 shares to Whitlock and 2000 shares to Duke Trust leaving Bednar with 1,867 shares. However, Bednar still owed Water Sports 3,333 shares (the 10,000 shares he purchased from Corliss as reduced by the three to one reverse stock split) leaving Bednar with a negative number of shares.

Second, Whitlock contended that on December 10, 1992, a two for one reverse stock split occurred and that Bednar's 20,000 shares were reduced to 10,000. Bednar then transferred 2,800

shares to Whitlock and 2,000 shares to Duke Trust leaving him with 5,200 shares. Bednar then transferred the 5,000 shares he received from Corliss (10,000 shares reduced two to one) to Water Sports leaving Bednar with 200 shares.

Third, Whitlock contended that when Bednar executed the Neyt redemption agreement, Whitlock automatically received 28% of the outstanding stock from Bednar, leaving Whitlock with 8,400 shares and Bednar with 11,600 shares. Thereafter Bednar transferred 20% of the outstanding stock (6000 shares) to Duke Trust, leaving Bednar with 5,600 shares. However, Bednar still owed Water Sports the 10,000 Corliss shares, which left Bednar with a 4,400 share deficit.

C. The Trial Court's Determination

On March 1, 1995, after three days of testimony and a painstaking examination of the corporate records and numerous agreements and draft agreements concerning the disputed transactions, the bankruptcy judge entered detailed findings of fact and conclusions of law.

She concluded that Bednar transferred his Corliss stock to Water Sports in December of 1992 leaving Bednar with a total of 10,000 shares. Thereafter, on January 4, 1993, several simultaneous transactions occurred: (1) Water Sports determined that it would be expedient to issue only 10,000 of its authorized shares; (2) Bednar surrendered his 10,000 shares in exchange for 5,800 shares; (3) Water Sports issued 2000 shares to the Duke Trust; and (4) Water Sports issued 2,800 shares to

Whitlock. The parties ignored the Neyt shares.

The bankruptcy judge gave careful consideration to each of the three alternative stock ownership theories presented by Whitlock, but rejected all three on the grounds that no reverse stock split had occurred and Whitlock had purchased a specific number of shares (*i.e.* 2,800) not a percentage of the stock. In the alternative, the court noted that because Whitlock and the Duke Trust purchased their shares from Water Sports, not Bednar, even if a reverse stock split had occurred, Bednar would still be the majority shareholder. In so holding, she noted that because it had legal (but not equitable title) to the escrowed Neyt shares, Water Sports could have issued the Neyt shares in violation of the escrow agreement.

Based on these findings, the bankruptcy judge granted Water Sports' motion for turnover of estate property and denied Whitlock's motion to dismiss.

STANDARD OF REVIEW

The bankruptcy court's conclusions of law are reviewed de novo. *Tilley v. Vucurevich (In re Pecan Groves of Arizona)*, 951 F.2d 242, 244 (9th Cir. 1991). Subject matter jurisdiction is also reviewed de novo. *Maitland v. Mitchell (In re Harris Pine Mills)*, 44 F.3d 1431, 1434 and 1438 (9th Cir.), *cert. denied*, -- U.S.--, 115 S.Ct. 2555 (1995). The bankruptcy court's findings of fact are reviewed for clear error. *Siriani v. Northwestern Nat'l Insurance Co., of Milwaukee, Wisconsin (In re Siriani)*, 967 F.2d 302, 303-304 (9th Cir. 1992).

DISCUSSION

On appeal Whitlock contends the bankruptcy court did not have subject matter jurisdiction to determine who held the majority interest in Water Sports. In the alternative, Whitlock sets forth a slightly different scenario under which he maintains he is the majority shareholder of Water Sports. He also maintains he is the majority shareholder under several new legal theories not argued below. In addition, although he withdrew his motion to dismiss, Whitlock now contends the bankruptcy court erred in not considering dismissal of the chapter 11 petition for bad faith.

A. Subject Matter Jurisdiction

Whitlock contends that the issue of who owns a majority interest in Water Sports is a noncore matter over which the bankruptcy court does not have subject matter jurisdiction. *See Wiley v. Costal Corporation*, 503 U.S. 131, 137 (subject matter jurisdiction may be raised at any time on appeal), *reh'g denied*, 504 U.S. 935 (1992). This distinction between core and noncore matters is important, because it determines whether the bankruptcy court has subject matter jurisdiction to decide the issue:

> In noncore matters, the bankruptcy court may not enter final judgments without the consent of the parties, and its findings of fact and conclusions of law in noncore matters are subject to de novo review by the district court. . . . In contrast to the bankruptcy court's authority in noncore cases, the bankruptcy court may enter final judgments in so-called core cases, which are

> appealable to the district court [or the BAP]. . . . .

In re Harris Pine Mills, 44 F.3d at 1436(quoting *Taxel v. Electronic Sports Research (In re Cinematronics, Inc.)*, 916 F.2d 1444, 1449 (9th Cir.1990) (other cases quoted in turn omitted); *see also* 28 U.S.C. § 157(b),(c).

The Ninth Circuit Court of Appeals has held that there are two types of core proceedings: proceedings "arising under" title 11, and proceedings "arising in" title 11. *See Harris Pine Mills*, 44 F.3d at 1435. Proceedings "arising under" title 11 are "proceedings that involve a cause of action created or determined by a statutory provision of title 11." *Harris Pine Mills*, 44 F.3d at 1435 (internal quotation marks omitted) (quoting *Eastport Assocs. v. City of Los Angeles (In re Eastport Assocs.)*, 935 F.2d 1071, 1076 (9th Cir. 1991) (as amended) (quoting in turn *In re Wood*, 825 F.2d 90, 96 (5th Cir. 1987) (footnote omitted))). Proceedings "arising in" title 11 are administrative matters "that are not based on any right expressly created by title 11, but [which] nevertheless, would have no existence outside of the bankruptcy." *Id.* (internal quotation marks omitted) (quoting *Eastport Assocs.*, 935 F.2d at 1076 (quoting in turn *Wood*, 825 F.2d at 97)). In contrast, noncore proceedings are proceedings "related to" title 11. *Id.* "If the proceeding does not invoke a substantive right created by the federal bankruptcy law and is one that could exist outside of bankruptcy it is not a core proceeding . . . ." *Id.*

(internal quotation marks omitted) (quoting *Eastport Assocs.*, 935 F.2d at 1076 (quoting in turn *Wood*, 825 F.2d at 97)).

Determination of whether the petition was properly filed is clearly a proceeding arising under title 11 as the right to file a petition is a creation of bankruptcy law and has no existence outside of bankruptcy. Thus, Whitlock's motion to dismiss is a core matter. Similarly, a motion for turnover of estate property is also a proceeding arising under title 11. *See* 28 U.S.C. § 157(a)(2)(A)(matters concerning the administration of the estate) and (E)(orders to turnover property of the estate).

However, in the present case the resolution of both proceedings hinges on a stock ownership dispute between third parties, governed exclusively by state law. Several courts have held that such controversies over the ownership of stock in a debtor corporation are noncore matters. For example in *Uranga v. Geib (In re Paso Del Norte Oil Co.)*, 755 F.2d 421, 424 (5th Cir. 1985), Uranga brought an adversary proceeding contending that Geib had fraudulently induced Uranga to sell his majority interest in the debtor. The bankruptcy court confirmed the chapter 11 plan over Uranga's objections and specifically retained jurisdiction to determine the stock controversy. The court of appeals first noted that a corporation does not have an ownership interest in its outstanding stock and that the controversy was therefore an action between third parties, not an action by or against the debtor. *In re Paso Del Norte*, 755

F.2d at 424. The court ruled that unless it was impossible for the bankruptcy court to administer the estate without first determining the controversy that the controversy was a noncore matter. The court concluded that the controversy had little effect on the administration of the estate and therefore the bankruptcy court had no jurisdiction to determine the action. *Id.*

If the order appealed in this case were merely a determination of the percentage of stock ownership of the Duke Trust, Bednar, and Whitlock, it would be a noncore matter. However, the proceedings appealed are the determination of whether the petition was properly filed and whether Whitlock had a right to remain in control of estate property. Because it is not possible to determine either controversy without first determining whether Whitlock or Bednar is the majority shareholder, it is impossible to administer the estate without first resolving the ownership dispute. Thus, under the Fifth Circuit's analysis, the issue of stock ownership is a core proceeding in this context.

The bankruptcy court reached the same conclusion in *Rosenblum v. Constantin (In re SCK Corp.)*, 54 B.R. 165 (Bankr.D.N.J. 1984). In *SCK*, the debtor corporation brought an adversary proceeding against Rosenblum seeking a determination that Rosenblum was no longer a shareholder of the debtor. Rosenblum then commenced a state court action against two other shareholders seeking a declaration that he was the majority

shareholder of the debtor. The defendant shareholders removed Rosenblum's state court action to the bankruptcy court. The bankruptcy court concluded it had jurisdiction over both actions because:

> control of a debtor in possession goes to the very heart of the administration of the debtor's estate, it necessarily follows that the bankruptcy court may properly determine where such control resides.

In re SCK Corp., 54 B.R. at 169. *C.f.*, *Izdebski v. Central Ice Cream Co. (In re Central Ice Cream Co.)*, 82 B.R. 933 (N.D.Ill. 1987)(in a chapter 7 proceeding in which there will be a surplus of funds available for distribution to the equity holders, a dispute concerning which shareholder has a controlling interest in the debtor is a noncore matter).

In the present case, both Whitlock's motion to dismiss and the Water Sports' motion for turnover of property hinge on whether Whitlock or Bednar controlled Water Sports. Thus, as in *SCK*, and unlike *Paso Del Norte*, knowing who controls the debtor is necessary to the administration of the estate.

In addition, we note that unlike the case in *Paso Del Norte*, in the present case Water Sports is a party to both the motion to dismiss and the turnover motion. Thus, the proceedings at issue are not merely disputes between third parties. Further, Whitlock's contentions regarding stock ownership go beyond who has ownership of the outstanding stock. Rather, Whitlock contends there are 12,000 shares outstanding, not the 10,000 shares shown on the debtor's books. He also

contends that various shares sold by the corporation were actually owned and sold by Bednar. Therefore, Whitlock's allegations concern not only who owns the corporate debtor's stock, but whether the debtor did or did not sell the stock. Accordingly, we conclude that the orders appealed do not merely resolve disputes between third parties, and that the bankruptcy court had jurisdiction to determine them.

Whitlock cites *Connell v. Coastal Cable T.V., Inc. (In re Coastal Cable T.V., Inc.)*, 709 F.2d 762 (1st Cir. 1983) for the proposition that the determination of who owns a majority interest in Water Sports is a noncore matter. In *Coastal Cable*, appellants pledged funds to promoter Paul Burke for the purpose of founding Coastal Cable and agreed to serve as its officers and directors. When Coastal Cable obtained a cable TV license, Burke refused to issue appellants share certificates and issued all of Coastal Cable's shares to himself. Burke then sold the shares to a third party who sold them to Berkshire Cable Television, Co. Berkshire filed for relief under chapter 11.

The bankruptcy court authorized the sale of Coastal Cable's TV license without first determining who owned the Coastal Cable's outstanding stock. The circuit court reversed and remanded to the district court for determination of who owned the Coastal Cable shares. The circuit court reasoned that the issue was primarily one of state law and that therefore *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 83 (1982) required that the matter be determined by the district

court.

Essentially, the First Circuit held that the bankruptcy court did not have subject matter jurisdiction over the sale unless Burke was the majority shareholder of the debtor and that the bankruptcy court was without subject matter jurisdiction to determine its own subject matter jurisdiction. Controlling case law is to the contrary. A bankruptcy court, like all other courts, always has subject matter jurisdiction to determine its own subject matter jurisdiction. *Visoneering Const. and Development Co. v. United States Fidelity & Guaranty (In re Visoneering Const.)*, 661 F.2d 119, 122 (9th Cir. 1981)(citing *Chichot Co. Drainage Dist. v. Baxter State Bank*, 308 U.S. 371, 376-77, (1940)). Accordingly, we conclude that because the determination of who is the majority shareholder of Water Sports is necessary to the determination of whether the petition was properly filed, the determination of who owns the majority interest is a core matter in the present proceeding.

B. Bad Faith

Whitlock contends for the first time in his reply brief that the bankruptcy court should have dismissed Water Sports' chapter 11 petition for bad faith because: (1) Bednar filed the petition to avoid a state court action brought by Whitlock; and (2) newly discovered evidence shows Bednar is looting Water Sports post-petition. Whitlock withdrew his motion to dismiss below. Nevertheless, Whitlock contends we should consider his motion on appeal because whether a petition is filed in good

faith is jurisdictional.

Whitlock cites *In re Coastal Cable*, for the novel proposition that whether a petition is filed in good faith is an issue of subject matter jurisdiction. In *Coastal Cable*, the court held that whether Coastal Cable had any debts was a matter of subject matter jurisdiction. The court concluded that if the appellants owned Coastal Cable's stock, then Coastal Cable did not have any debts. The court added that whether appellants or Berkshire owned the stock depended upon whether Burke committed fraud by issuing the stock to himself. *Coastal Cable*, 709 F.2d at 765. *Coastal Cable* did not hold that "bad faith" is a matter of subject matter jurisdiction. Nor are we aware of any cases holding that bad faith is a matter of subject matter jurisdiction. Accordingly, we decline to consider Whitlock's allegations of bad faith.

C. Who is the Majority Shareholder of Water Sports?

In the alternative, Whitlock contends that even if the case is not dismissed, he should not be required to return the corporate records of Water Sports because he is the majority shareholder. Whitlock maintains that in accordance with Bednar's November 1992 letter, when Bednar signed the redemption agreement with Neyt, he automatically became the owner of 7,500 shares (*i.e.* 25% of the outstanding shares of Water Sports which had previously belonged to Bednar) leaving Bednar with 12,500 shares. Thereafter, Bednar returned the 10,000 Corliss shares to Water Sports, leaving him with 12,500 shares. Then, on

January 5, 1993, Bednar gave Whitlock an additional 900 shares (bringing Whitlock's percentage of all of the authorized shares to 28%) leaving Bednar with 1,600 shares and Whitlock with 8,400 shares. Simultaneously, Water Sports issued 2,000 shares to the Duke Trust.

This argument assumes that an agreement to transfer stock automatically accomplishes the transfer thereof. However, certificated securities are transferred under Oregon law only when (1) the purchaser or his agent acquires possession of bearer certificates (O.R.S. § 78.3130(1)(a), (e)(1993)); or (2) the purchaser or his agent acquires possession of endorsed share certificates (O.R.S. § 78.3130(1)(c), (e)(1993)). Recognizing that he could not have received certified shares by operation of the November 1992 letter, Whitlock contends that pursuant to O.R.S. § 78-3080 (1993), uncertificated shares[2] were transferred to him by written instruction.

However, the shares originally issued by Water Sports were

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[2]O.R.S. § 78.1020(1)(b)(1993) provides in relevant part:

> (1)(b) An "uncertificated security" is a share. . . of the issuer . . . which is:
> (A) Not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer;
> (B) Of a type commonly dealt in on commercial exchanges or markets; and
> (C) Either one of a class or series or by its terms divisible into a class or series of shares . . . .

all certificated, and all of the shares subsequently issued by the Water Sports were certificated. At the time Whitlock contends Bednar transferred 7,500 uncertificated shares to him, all of Bednar's shares were documented by a certificate for 20,000 shares. Thus, Bednar did not own any uncertificated shares.

Shareholders cannot create uncertificated shares. Only the corporation can issue uncertificated shares. *See* O.R.S. § 60.164 (1993)(providing that absent a prohibition in the bylaws or articles of incorporation, the board of directors may authorize the issuance of shares without certificates). Water Sports' board of directors never authorized the issuance of uncertificated shares. Accordingly, Bednar could not have sold Whitlock any uncertificated shares.

D. Burden of Proof and Factors Considered by the Court

Whitlock also contends that the bankruptcy court improperly assigned the burden of proof on Water Sports' motion for turnover of estate property to Whitlock. However, there is no indication in the opinion or the transcript that the bankruptcy court placed the burden of proof on Whitlock.

In addition, Whitlock contends the bankruptcy court considered "impermissible factors" in reaching its conclusion. It is difficult to determine from his brief what "factors" Whitlock objects to. However, we surmise from page 2 of his opening brief that he believes the bankruptcy court's opinion was based on hearsay testimony regarding the ownership of the

corporate stock. No objection to the "hearsay" was made below and much of this so-called impermissible testimony was presented by Whitlock himself. Further, the parties to the transactions (Whitlock, John Duke (a principal of the Duke Trust), and Bednar) all testified as to their own involvement in the transactions and to their own personal intent. Where the contracts were not entirely oral, the court was presented with the written contracts themselves. Accordingly, the bankruptcy court did not base her decision on inadmissible hearsay.

Whitlock also contends the Court erred by requiring the shareholders to document corporate transactions. The bankruptcy judge did note that the transactions between the parties were frequently undocumented. She did not hold that shareholders have the burden of documenting corporate transactions.

Accordingly, we conclude the bankruptcy court neither misapplied the burden of proof, nor considered "impermissible factors."

E. Issues Raised For the First Time on Appeal

On appeal, Whitlock raises three new theories as to why he is the majority shareholder of Water Sports, the doctrine of unclean hands, breach of contract, and equitable subordination.

> Generally, an appellate court will not consider arguments not first raised before the district court unless there were exceptional circumstances. *Valuer v. Crowley Maritime Corp.*, 782 F.2d 1478, 1483 (9th Cir. 1986). The specific "exceptional circumstances" that this circuit has identified are as follows: (1) review is necessary to prevent a miscarriage of

> justice; (2) a new issue arises while an appeal is pending because of a change in the law; and (3) the "issue presented is purely one of law and either does not depend on the factual record developed below, or the pertinent record has been fully developed." *In re Bolker v. C.I.R.*, 760 F.2d 1039, 1042 (9th Cir.1985).

Briggs v. Kent (In re Professional Inv. Properties of America), 955 F.2d 623, 625 (9th Cir.), *cert. denied*, 506 U.S. 818 (1992); *See also Trattoria v. Lansford (In re Lansford)* 822 F.2d 902, 905 (9th Cir. 1987)(applying rule to bankruptcy proceeding).

Neither the doctrine of unclean hands, the equitable subordination, nor the breach of contract contention meets the above exceptions to the rule. Further, all three contentions are raised for the first time in Whitlock's reply brief. *See Kirkland v. Security Pacific National Bank (In re Kirkland)*, 915 F.2d 1236, 1241 n.7 (9th Cir. 1990); *The Preservation Coalition, Inc. v. Pierce*, 667 F.2d 851 (9th Cir. 1981).

Even if we could consider these new causes of action under *Briggs v. Kent*, it would be inappropriate to do so because all three causes of action concern remedies for fraud or breach of contract not current legal title to corporate stock. The motion for turnover of estate property is determined by who is legally in control of the debtor-in-possession, not who might gain legal title through a civil action. Whether Bednar or Water Sports has breached a contract, or defrauded Whitlock is beyond the scope of Water Sports' motion for turnover of estate property. Accordingly, we decline to consider Whitlock's new causes of

action.

Also raised for the first time in Whitlock's reply brief is his contention the bankruptcy court should have summarily dismissed either the turnover motion or the petition for relief in favor of the pending state court action. However, no motion to abstain was ever filed and the issue is raised for the first time on appeal. The filing of a motion to abstain is a necessary element to a request for mandatory abstention. See 28 U.S.C. 1334(c)(2). This issue will not be considered on appeal.

F. The Appellee's Request That the Order Denying Whitlock's Motion to Dismiss Be Reversed

Water Sports contends that the bankruptcy court erred in denying Whitlock's motion to dismiss because Whitlock had previously withdrawn the motion. To the extent the motion concerns the validity of the petition, it is jurisdictional and cannot be waived. The bankruptcy court did not err in denying the motion to dismiss.

CONCLUSION

Generally, disputes concerning the ownership of stock issued by a debtor corporation are not core proceedings. However, in the present case, the determination of who owns the corporate stock in the debtor is an integral part of two core questions: (1) was the petition for relief properly filed; and (2) who is authorized to act and hold property for the debtor-in-possession. Accordingly, the bankruptcy court had core jurisdiction to determine the ownership of the stock.

The bankruptcy court order was based on a meticulous and thorough analysis of the stock ownership of Water Sports. The bankruptcy court's finding that Bednar owns the majority of the corporate stock is supported by the testimony of Bednar, John Duke, and Grantland as well as by the documentation admitted into evidence. Accordingly, the bankruptcy court correctly concluded that Bednar, not Whitlock, is the majority shareholder of Water Sports. The bankruptcy court's order requiring Whitlock and DiBasi to return Water Sports' corporate records is AFFIRMED.

Because Whitlock withdrew his motion to dismiss, he may not contend on appeal that his motion to dismiss should be granted on the grounds of bad faith. His contention that Bednar did not have corporate authority to file the petition is jurisdictional and should be considered on appeal. However, as the bankruptcy court's finding that Bednar had the authority to file the petition on behalf of Water Sports is correct, her decision to deny Whitlock's motion to dismiss is AFFIRMED.